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## Croatia in the European Union: A Study on Foreign Direct Investment, Unemployment, and Infrastructure

Mary Grace Boland

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CROATIA IN THE EUROPEAN UNION: A STUDY ON FOREIGN DIRECT INVESTMENT,  
UNEMPLOYMENT, AND INFRASTRUCTURE

By  
Mary Grace Boland

A thesis presented in partial fulfillment of the requirements for completion  
Of the Bachelor of Arts degree in International Studies  
Croft Institute for International Studies  
Sally McDonnell Barksdale Honors College  
The University of Mississippi

University, Mississippi  
May 2014

Approved by:

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Reader: Dr. Kees Gispen

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Reader: Dr. Jeanette Martin

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## ABSTRACT

This study aims to determine the possible economic success or failure of Croatia in the European Union based on three economic indicators: foreign direct investment (FDI), unemployment, and infrastructure. It also seeks to compare other economic indicators such as GDP growth and inflation of Croatia to the other 27 member-states of the European Union. The goal of this paper is not to predict the future of Croatia, but to discover areas of potential reform and to support existing research on determinants of economic success in the EU. The three chapters that focus on FDI, unemployment, and infrastructure explore the respective sector in transition economies and specific issues regarding that sector in Croatia. The following chapters compare Croatia to other EU member states and provide managerial implications for global business. In general, FDI, unemployment, and infrastructure prove to be factors in Croatia's future in the EU, while FDI and unemployment are found to be obstacles that need to be overcome before Croatia can make great strides in the EU market, while infrastructure results in more positive findings. In addition, Croatia is found to be the most similar to countries with the lowest GDP in the EU. This study concludes that an immediate entrance into the EU will not automatically improve the economy of Croatia.

## TABLE OF CONTENTS

LIST OF TABLES.....	vi
LIST OF ABBREVIATIONS.....	vii
CHAPTER I: INTRODUCTION.....	1
CHAPTER II: BACKGROUND.....	5
CHAPTER III: FOREIGN DIRECT INVESTMENT.....	18
CHAPTER IV: UNEMPLOYMENT.....	26
CHAPTER V: INFRASTRUCTURE.....	34
CHAPTER VI: COUNTRY COMPARISONS.....	42
CHAPTER VI: MANAGERIAL IMPLICATIONS.....	51
CONCLUSION.....	60
BIBLIOGRAPHY.....	viii

## LIST OF FIGURES AND TABLES

### FIGURES

Figure 2.1: Timeline of European Union.....	7
Figure 2.2: Timeline of Croatia's EU Accession Process.....	10
Figure 3.1: FDI Inflow in Croatia.....	21
Figure 4.1: Long Term vs. Total Unemployment.....	28
Figure 4.2: Youth Unemployment 2004-2014 in Croatia.....	30
Figure 4.3: Youth vs. Total Unemployment.....	31
Figure 6.1: GDP per capita EU countries.....	44

### TABLES

Table 2.1: Summary of EU Countries.....	8
Table 2.2: Possible Future EU Countries .....	10
Table 3.1: Croatian FDI inflow.....	21
Table 5.1: Infrastructure in Croatia.....	37
Table 6.1: GDP per capita of EU countries.....	40
Table 6.2: Break-up of EU countries.....	41
Table 6.3: Group Averages. ....	46
Table 6.4 Croatia's comparisons.....	48

## LIST OF ABBREVIATIONS

BOP	Balance of Payments
CEEC	Central and Eastern European Countries
EU	European Union
FDI	foreign direct investment
GDP	Gross Domestic Product
IBRD	International Bank for Research and Development
ILO	International Loan Organization
IMF	International Monetary Fund
MMG	multinational market group
MNC	multinational corporations
PPS	purchasing power standard
PPP	purchasing power parity
OECD	Organization for Economic Co-operation and Development
USD	United State's Dollars
WB	World Bank



## Chapter 1: Introduction

*"Croatia has demonstrated its ability to fulfill all commitments in good time before accession. EU membership offers many and substantial opportunities for Croatia and the EU. These opportunities now need to be used, so that Croatia's participation in the EU will be a success – to the benefit of Croatia itself, of the Western Balkans region, and of the EU as a whole."*

European Commission Monitoring Report, March 2013

*"Croatia is in a hectic economic situation. Croatia is entering the EU when the EU is not at its best. The fact that the EU is in crisis is helping that ... lack of any optimism"*

Croatian economist Davor Gjenero, 2013

July 1, 2013 marked the most recent enlargement of the European Union (EU), adding the Balkan, ex-Yugoslav state of Croatia. This makes the European Union the largest free trade market with 28 members. The admittance of Croatia is both, if you will, exciting and nerve-wracking, for the European Union and the country itself. A number of political scientists and economists are scared about the future of the EU. Will a market that large really benefit all of the members and outsiders? From these general questions stem even more questions.

The discussion is that Bulgaria and Romania entered the EU too early, that their implementation of required reforms did not match the EU standards well. The discussion concerns the admittance of Croatia leading to the other Baltic nations anticipating admission (some are currently in the negotiation process), and is this a bad or good route for the EU? Will these transition economies prosper in the EU? With the global economic crisis not so many years past, is now the time for middle-

income countries to join? These questions may have a negative tone, but there are also many positive facts of EU enlargement today.

The EU accession process has strict political (e.g., corruption, judiciary standards, etc.) standards that improve the politics of the country. Their economic standards strive to increase economic growth in applicant countries so that they may successfully conduct global business. Croatia will gain new trading partners as a new member of the EU. In broader terms, globalization continues to change the game of international business everyday. The movement of a transition economy into the EU is just one example of globalization.

This paper examines Croatia as broadly as possible, as an example of how global economics are changing, and specifically, its accession into the EU and how specific economic factors could provide a basis for what Croatia's future in the EU could look like. It is impossible to predict the future of a country. It is impossible to include every factor that would determine the future of a country. However, this study will examine a number of specific economic factors that can either show the success, stagnation, or failure of a country that has undergone major policy and economic changes to become a member of the EU.

The two quotes at the beginning of the thesis provide two general ideas regarding Croatia's accession into the EU: the positive and the negative, from which stems the basic research question. Will the future of Croatia in the European Union be a success or failure, and what will it take to be successful? The study discusses three economic factors specifically and how they might affect Croatia in the EU market. The three indicators are foreign direct investment (FDI), unemployment, and

infrastructure. The reasoning behind the choice of these three indicators is explained later in following chapters.

The research is separated into seven chapters, with two broad overlaying sections. Following the introduction, Chapter 2 introduces the accession process of the EU and transition economies in general. Chapter 3 discusses the FDI atmosphere in Croatia, followed by Chapter 4 on unemployment in Croatia. A fifth chapter examines the role of infrastructure in Croatia. These three chapters explore the respective sector in transition economies and specific issues regarding that sector in Croatia. They predominantly provide an overview and an idea of how that sector is changing in Croatia and what the future of that sector may look like. The *EU Comprehensive Monitoring Report in 2012* on Croatia's preparedness after negotiations were closed outlined issues that were still necessary to reform for Croatia to succeed. The report mentioned the following, which is where the three economic factors of discussion for this paper were derived from: FDI, unemployment, and infrastructure.

- *"In the area of labor markets in particular, where already low levels of employment and participation declined further, reforms are still at a very early stage and need urgently to be stepped up"* (**Unemployment**).
- *"The investment climate continued to suffer from heavy regulatory burden lengthy procedures, uncertainties in the legal environment, unpredictability of administrative decisions, and a high number of non-tax fees."* (**FDI**).
- *"Enhancing the efficiency of public spending remains a key challenge"* (**Infrastructure**) (European Commission 2012).

The next broad section is a comparison of Croatia to other countries in the EU, and how the three major economic indicators, as well as other factors compare. A concluding section provides implications for Croatia, its citizens, and local business

entering into the global marketplace based on the discussion of indicators and comparisons to other EU countries. The goal of this paper is not to predict the future of Croatia, but to discover areas of potential reform and to support existing research on determinants of economic success in the EU. By comparing Croatian data to that of other countries in the EU, this paper aims to find the direction that Croatia will head in its status as the newest member of the EU.

## **Chapter 2: Background**

On July 1, 2013 Croatia became the newest member of the European Union (EU). The accession process into the EU is based on many factors and it takes time and effort of the incoming country to meet the EU standards. To put the accession of Croatia into context, a brief history of the EU will be given, defining and separating the different types (founding, transition, etc.) of countries, followed by an explanation of the foundations of the EU and brief explanation of Croatia's accession process and the criteria to join to the EU.

The European Union is a common market, which means there is free movement of people and capital among member states. To become a member of the EU, a country must have certain attributes that are economically, politically, geographically and socially shared. As a multinational market group (MMG), the EU designed the foundations of their union strategically based upon the before-mentioned characteristics. The foundations are as follows (Harvey 2013):

1. The standardization of frontier controls.
2. The freedom of movement and right of people to settle in member countries.
3. Technical and standards harmonization.
4. The opening-up of government procurement markets
5. The liberalization of financial services market.
6. The gradual opening up of the information services market
7. The liberalization of transportation services.
8. The creation of suitable conditions for industrial cooperation without fear of antitrust violation.
9. The removal of fiscal barriers.

The EU is a multinational market group (MMG), meaning a group that is created by different countries that want to take positive steps to reduce trade barriers among the members. The EU “is trying to sustain economic growth by investing in transport, energy and research, while also seeking to minimize the environmental impact of further economic development” (European Union 2013). The economic cooperation of the EU has the potential to bring about political and social benefits. It is important to look at the factors to success for MMGs, because it is crucial that Croatia fits into these categories in becoming a member of the EU. The following list relates the factors for success to Croatia’s situation in the European Union with questions:

1. Economic factors: Is Croatia at the trading level of the European Union. Does it have a balance of trade? Does it have resources that the EU and the rest of the world needs? What can they do to increase the trading power in Croatia?
2. Political factors: Does the Croatian government cooperate with other EU governments? Internally, is the Croatian government stable and non-corrupt?
3. Geographic factors: Croatia is geographically compatible with other countries of the EU. It is located closely to members of the European Union and to the other transition economies that are working on becoming members of the EU, connecting the Western Europe to Central and Eastern Europe. How does this benefit both sides?
4. Social factors: Social factors are also important in determining the way countries work together? Does the Croatian society support the EU and Croatia’s involvement within the EU? Do Croatian values and ethics go along with those of the other EU countries? Will society change dramatically as a result of EU accession?

After World War II, a number of countries made a significant effort to increase economic development and cooperation between the destructed countries. The aftermath of the war left Europe in a state of economic distress, and countries wanted to re-strengthen Europe after its deterioration. See Figure 2.1 that briefly explains EU expansion (European Union 2013b).

**Figure 2.1**

**Timeline of European Union**



The six founding countries of the EU are Belgium, Germany, France, Italy, Luxembourg, and the Netherlands. They will be defined as Group **A**. Since then, 22 other countries have joined. The expansion process has introduced different markets into the largest free trade union. The first expansion added Denmark, Ireland, and The United Kingdom. In 1981 Greece joined the EU, followed by Spain and Portugal in 1986. By 1995, nearly the entirety of Western Europe composed the EU with the addition of Austria, Sweden, and Finland. These nine members of Western Europe will be defined as Group **B** of the EU. They are defined by their market economies and historical stability, extremely similar to Group **A** minus the fact of being founding members. The global market crash of 2008 has troubled some of these countries,

mainly Greece, Italy, and Spain; however, for this paper's purposes, they will be included in the Groups **A and B** market economies.

The largest enlargement of the EU so far was in 2004, with the addition of the Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovakia, and Slovenia. Each of these countries had been under the control of Communist Russia, and Slovenia is the only country from the former Yugoslavia. The economic turmoil after the fall of the Iron Curtain (the end of the Cold War in 1991) allowed for the transformation into a new type of economy, moving from centralized planning to a free-market orientation. These countries are labeled as *transition economies*. In 2007, two more Eastern European transition countries, Romania and Bulgaria, joined the EU. This introduced Groups **C and D** of countries in the EU. Group **C** includes all transition economies, except the two countries of ex-Yugoslavia, Slovenia and Croatia, which will make up Group **D**.

**Table 2.1**

**Summary of EU Countries**

Group	Country	Accession Date	Category	Eurozone
A	Belgium	1957	Founding/Western Europe	Yes
A	France	1957	Founding/Western Europe	Yes
A	Germany	1957	Founding/Western Europe	Yes
A	Italy	1957	Founding/Western Europe	Yes
A	Luxembourg	1957	Founding/Western Europe	Yes
A	Netherlands	1957	Founding/Western Europe	Yes
B	Austria	1995	Western Europe	Yes
B	Denmark	1973	Western Europe	No



B	Finland	1995	Western Europe	Yes
B	Greece	1981	Western Europe	Yes
B	Ireland	1973	Western Europe	Yes
B	Portugal	1986	Western Europe	Yes
B	Spain	1986	Western Europe	Yes
B	Sweden	1995	Western Europe	Yes
B	United Kingdom	1973	Western Europe	No
C	Bulgaria	2007	Transition	No
C	Cyprus	2004	Transition	Yes
C	Czech Republic	2004	Transition	No
C	Estonia	2004	Transition	Yes
C	Hungary	2004	Transition	No
C	Latvia	2004	Transition	Yes
C	Lithuania	2004	Transition	No
C	Malta	2004	Transition	No
C	Poland	2004	Transition	No
C	Slovakia	2004	Transition	Yes
C	Romania	2007	Transition	No
D	Slovenia	2007	Transition/ex-Yugoslavia	Yes
D	Croatia	2013	Transition/ex-Yugoslavia	No

(Eurozone: countries that use the Euro as the national currency; some countries choose not to adopt the Euro while others are not economically stable enough to use as determined by the EU).

The expansion of the EU into Eastern and Central Europe increased the number of EU countries to 27. Five years later, Croatia, the country of interest for this paper, and the second country of ex-Yugoslavia after Slovenia, joined the EU. The Balkans director at the International Crisis Group, Marko Prelac, explained that Croatia should be an example for the addition of other Balkan nations. He stated, “If Croatia turns into a problem child for the EU, then it’s going to be next to impossible for anyone else to join. But if it goes well, then the doors will be open for its neighbors, too” (Bilefsky 2013). Table 2.1 shows the countries in the application and negotiation process.

**Table 2.2**

**Possible Future EU Countries**

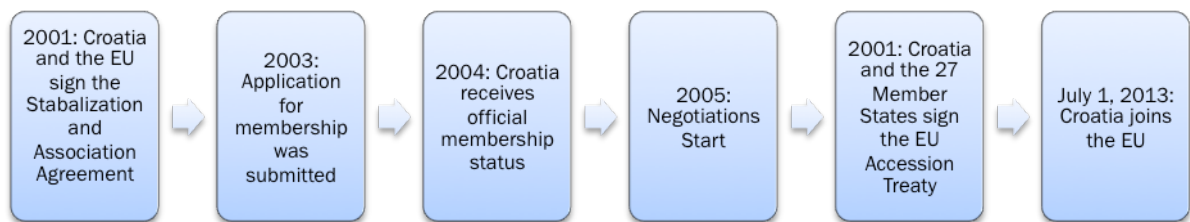
Candidate countries	Macedonia, Iceland, Montenegro, Serbia, Turkey
Potential Candidate Countries	Albania, Bosnia and Herzegovina, Kosovo

Source: Information from European Commission (2013b)

Candidate countries are defined as countries still in the negation process or waiting to start and potential candidate countries are defined as countries promised the prospect of joining when they are ready (European Commission 2013b).

**Figure 2.2**

**Timeline of Croatia's EU Accession Process**



Source: Information from European Commission (2013b); Author's Figure

The process of Croatia's accession into the EU lasted a little longer than ten years. When Croatia joined the EU, it lost membership in the Central European Free Trade Agreement (CEFTA: Albania, Bosnia and Herzegovina, Macedonia, Moldova, Montenegro and Serbia), along with \$200 million a year in lost exports (Trifkovic 2013). However, in joining the EU, Croatia will be exposed to an even larger market. The signing of the Stabilization and Association Agreement began this process in 2001 and in 2003 Croatia submitted their application for membership. The EU has a slightly different process for the Western-Balkan nations, the Stabilization and

Association agreement. This framework focuses on stabilizing the politics and having a smooth transition into a market economy, promotes regional cooperation, which results in eventual EU membership. With additional political and economic assistance, the Western-Balkans can more easily move toward EU membership. In 2004 Croatia received official candidate status and the approval for negotiations to begin in 2005.

A significant component of the EU's decision to begin negotiations with Croatia was the country's willingness to cooperate with the International War Crimes Tribunal in The Hague. After six years of accession negotiations, Croatia and the 27 Member States signed the EU accession treaty, and finally on July 1, 2013, Croatia became the 28<sup>th</sup> member of the EU. The negotiations of Croatia focused mainly on the state of the economy and corruption, which are still factors in the success of its accession. The "Copenhagen Criteria" or basic criteria for joining the EU, as outlined on the European Commission website, are that countries should have:

- 1) Stable institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
- 2) A functioning market economy and the capacity to cope with competition and market forces in the EU;
- 3) The ability to take on and implement effectively the obligations of membership, including adherence to the aims of political, economic and monetary union (European Commission 2013a).

Croatia met these criteria, but this paper aims to show the challenges and or accomplishments that will possibly predict the economic actions of Croatia and their future within the EU.

In 2011, after negotiations were closed, the European Commission released a status update on Croatia. It defined Croatia as a “functioning market economy,” but also stated, that “vigorous implementation of urgently needed structural reforms should enable Croatia to cope with competitive pressures and market forces within the Union in the near term” (European Commission 2011, p. 5). They also recognized that reforms “urgently needed to be stepped up” regarding unemployment and that the investment climate was suffering (European Commission 2011, p. 5). If Croatia implements reforms quickly and changes their unemployment and FDI levels, they will be a more competitive player in the EU market.

It is important to understand transition economies in general and possible other problems before specifically discussing the three chosen economic indicators. There are four staple “ingredients” of the transition process from the ex-Soviet countries’ fall from communism. They are liberalization, macroeconomic stabilization, restructuring and privatization, and legal and institutional reforms (IMF 2000). Each of these plays a significant role in the transformation to a market economy, and the IMF points out that liberalization and macroeconomic stabilization occur relatively quickly, while large-scale privatization and institutional reforms take a greater amount of time (IMF 2000). The IMF also states that the countries of Central Europe and the Baltics have, for the most part, reached the middle-income rank of countries, but now “face the challenges posed by accession to the EU, and by the process of catching-up with the richer nations” (IMF 2000). The difficulties of transition economies may seem worse because of other factors: the success and growth of advanced western economies, the problems of transition economies that were

underestimated, and the fact that policy makers made questionable choices (Svejanr 2002).

Scholars have found a way to conceptualize EU accession, and although this paper deals with more specific economic factors, it is important to recognize that the process of joining the EU is not just a process where a country signs up and automatically becomes a successful member. New members must adapt to EU ways, and the EU must also adapt to new countries.

Recently, there have been certain scholars who define the process of countries moving toward European politics and economics, as well as their social and cultural integration into European society. The two theories discussed that are pertinent to this paper are Europeanization and EU-ization. As one might guess from the titles, these theories are inherently similar but have some important definitional differences that will be explained later. These are not theories of EU enlargement policy, but in fact ways that the enlargement process affects both the EU and the member states and applicant states (Grabbe 2002). There is not an overwhelming consensus to this day on the legitimacy of these theories, but for this paper's purpose, they set the stage for a country entering the EU and how the EU affects and changes the politics and economics of the country.

There is a consensus, however, that Europeanization works in two different ways 1) countries shape EU policies and 2) the EU has a significant influence on national politics and economics, namely in transition and applicant countries, as they have more political and economic standards to adapt to. The EU pushes countries to change and implement policies before they become members; therefore the EU has an effect on the decision-making of country leaders. Europeanization has multiple

definitions and has both a “top down” and “bottom up” approach, depending on the actions of the countries, meaning Member States’ governments “both shape European policy outcomes and adapt to them” (Borzel 2002, p. 194). Radeilli (2000) defines the “bottom down” approach to Europeanization, with an emphasis on the actual process of ascending into the EU:

‘Europeanization consists of processes of a) construction b) diffusion and c) institutionalization of formal and informal rules, procedures, policy paradigms, styles, “ways of doing things,” and shared beliefs and norms which are first defined and consolidated in the EU policy process and then incorporated in the logic of domestic (national and subnational) disclosure, political structures and public policies,’

While Cowles et al (2001) defined Europeanization from a “top up” approach:

‘The emergence and development at the European level of distinct structures of governance, that is, of political, legal, and social institutions associated with political problem solving that formalize interactions among the actors, and of policy networks specializing in the creation of authoritative European rules’ (Cowles 2001, p. 3).

Grabbe (2002) argues that Europeanization in the transition economies, the CEEC (central and eastern European countries), is different because it is impossible for these countries to influence EU policies, as they are not yet members. She finds that there is a similarity between member states and applicant states, but that the Europeanization of applicant states is “broader and deeper in scope” (Grabbe 2002, p.2). However, it is important to note that now, in 2014, many transition economies are member states, but her argument is still relevant for the transition economies

that are new members (Croatia) and applicant countries (specifically other Balkan nations: Bosnia and Herzegovina, etc.). Applicant countries are more likely to be influenced by “top down” Europeanization because they have a “stronger incentive than existing members to implement EU policies because they are trying to gain admission” (Grabbe 2002, p. 2). One can conclude from this that Croatia was recently affected by ‘top down,’ and some day, may be a component of the ‘bottom up,’ if their economy and politics should cause a need to change EU policy.

Recent scholars have discussed a different theory of the effects of accession into the EU, EU-ization which is a more narrow approach to the influence of Europeanization. However, it is important to note that some scholars, specifically Wallace (2000), argue that Europeanization is more important for candidate countries, while EU-ization is more pertinent to member states. Because Croatia is, as of July 2013, a member state, EU-ization will also be discussed and compared to Europeanization, to frame the change in economic policy that Croatia has made ascending into the EU and how they may or may not quickly become “Europeanized,” in the economic sense for the purpose of this paper.

Europeanization has been defined by many scholars in many different specific situations, as seen above, providing a rather broad definition. In addition, some scholars in fact define “EU-ization,” but using the term of *Europeanization*, making a specific definition even more difficult to pin down. However, EU-ization is a more narrow approach to Europeanization, specifically revolving around the entity of the EU, rather than other social and cultural matters of Europeanization (Flockhart 2010). Flockhart concludes, “EU-ization does not imply membership of a cultural community, but merely indicates fulfillment of the conditions for political encounters

with the EU” (791). Some scholars note that Radeilli (2000) and other scholars who include EU policies in their definitions of Europeanization are actually defining EU-ization. It is important to note, also, that Europeanization and EU-ization are not mutually exclusive and that EU-ization cannot be fully separated from Europeanization (Radielli 2000).

Now that both Europeanization and EU-ization have been defined and conceptualized, their relationship to Croatia’s accession into the EU and Croatia’s progress as a member-state must be discussed. Because this paper focuses on three specific economic factors, EU-ization is more relevant and helpful for this paper: How has the EU shaped and changed the economy and politics of Croatia? While both Europeanization and EU-ization are occurring in Croatia, the “fulfillment of conditions” and how they have continued with “encounters” in the EU play a more significant role in the hypothesis of this paper (Flockhard 2010). Croatia has undergone and is currently undergoing EU-ization, as it changes its policies, both economic and political, to meet EU standards. Even though Croatia has already proved to change many of their policies to become a member of the EU, the country must continue to change and implement policies if it wants to truly succeed in the EU over time. In the future, Croatia could become a part of the ‘bottoms up’ view of Europeanization, where Croatia’s politics and economics shape EU policies and conditions.

This section is not to solely define and differentiate Europeanization and EU-ization, but to recognize that there are theories and discussions in the academic world that attempt to analyze and explain movements into Europe, whether it be politically and economically in the EU or culturally and socially as Europeans. The EU



accession process is not just a checklist, but it is something that can inherently change the historical behavior of a country and their future as members of the EU and European community. Once this is acknowledged, the actuality of Croatia's success and progress as a member of the EU can be based on and partially explained by their change in economics and policies as a new member-state.

The EU accession process, discussion of Europeanization, and brief description of transition economies provide the basic atmosphere for the remainder of the research, which is as mentioned before, specific findings on FDI, unemployment, and infrastructure in Croatia, comparisons to other EU countries, and the implications of the results of the comparisons for Croatia.

### **Chapter 3: Foreign Direct Investment**

Globalization, or the rapidly evolving economic integration of countries around the world, has caused many changes in the world economy. A key determinant and factor in this phenomenon is Foreign Direct Investment (FDI) (Sauvant et al. 2009). During the 1990s, FDI became increasingly important and visible with the rapid change and connection of world economies (Bevan and Estrin 2004). Another phenomenon was occurring during this time period, the transition of the Central and Eastern European Countries (CEEC) from centrally planned economies to market economies. Before delving into FDI and transition economies, specifically Croatia, I will define and explain FDI so that comparisons over countries and over time can be made and analyzed.

According to the World Bank, FDI consists of the “net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor” and “the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments” (World Bank 2013c). In other words, FDI is the cross-border economic interactions of enterprises, when the investor (home country) enters a different, recipient country (host country). Scholars agree that FDI plays a part in the development of the host country’s economy and that it is a catalyst in the movement of capital, but also technology and know-how. It also increases the “competitive position of the recipient and investing economy” (Sauvant

2009). However, during the recent global crisis (2008-2009), FDI growth significantly decreased, along with Gross Domestic Product (GDP) worldwide, with the European Union (EU) having a significant decline of 40-60% in FDI (Derado 2013). The rapidity of globalization mixed with financial crises makes it difficult for multinational corporations (MNC) to decide whether to invest in a foreign country. It also presents a challenge for the host country, because its economy must integrate the international market with its own economic capacity for FDI (Derado 2013).

At this point, it is necessary to introduce transition economies into the FDI equation. The United Nations Center for Trade and Development (UNCTAD) reports that the GDPs of transition economies were expected to grow by three percent in 2013, although their economic performances have been more negative since the worldwide economic crisis (United Nations 2013). They also report that GDP was expected to shrink in the EU (United Nations 2013). These negative projections particularly affect “less advanced transition economies” (Derado 2013). However, developed economies are attracted to these emerging economies because they provide new and different investment opportunities. The determinants of FDI in transition economies are essential to look at before looking at one country in particular, because for the most part the Central and Eastern European Countries (CEEC) have similar trends. Evidence shows that many transition economies remained “unattractive to foreign direct investment” (Svejnár 2002, p. 16). Scholars agree that proximity to joining the EU is a determining factor of investment from stable economic countries, as well as the attractiveness of the political, economic, legal environment and privatization projects (Derado 2013; Svejanar 2002).

Evidence shows that FDI is based on defining factors in transition economies, including gravity factors, proximity, cost-related factors and market size among others. However, whether it is in a positive or negative way, this paper aims to show that FDI does play a significant role in the transition of Croatia into the EU.

There are both positive and negative aspects in broadly looking at FDI in Croatia. On one side, Croatia is similar to the more advanced Central Eastern European Countries. However, since the global economic crisis of 2008 and 2009, FDI, on a global level, has decreased. Another issue is the motivation of the investors. For the most part, in the CEEC, privatization of enterprises has been the focus of investment. But in this global economy, a more service-based system is also important. Table 3.1 and Figure 3.1 show the FDI trend in Croatia from 2002-2012 (World Bank 2013b).

**Table 3.1**

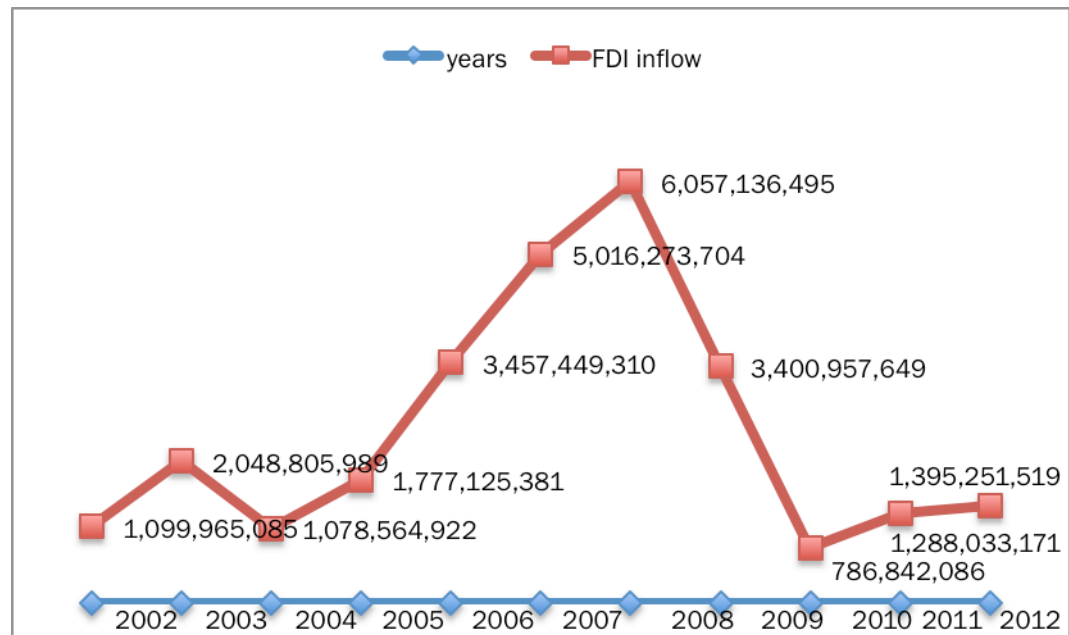
**FDI Inflow in Croatia**

<b>Year</b>	<b>FDI inflow</b>
2002	1,099,965,085
2003	2,048,805,989
2004	1,078,564,922
2005	1,777,125,381
2006	3,457,449,310
2007	5,016,273,704
2008	6,057,136,495
2009	3,400,957,649
2010	786,842,086
2011	1,288,033,171
2012	1,395,251,519

Source: data retrieved from World Bank 2013b;  
<http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD>; author's table

**Figure 3.1**

**FDI inflow in Croatia**



Source: data retrieved from World Bank 2013b;  
<http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD>; author's chart

The United States' "Doing Business In," provided by the Department of Commerce, however, has labeled the business and investment climate in Croatia as "difficult, requiring caution and patience for success by foreign companies." However, they also note that the Croatian government has made significant strides in reforms and has found new ways to "consolidate public spending, improve the business climate, and foster economic growth." Croatia is a "market of opportunity, but one that should be entered with due diligence" (U.S. Dept. of Commerce 2013, p.17).

Croatia's different forms of FDI are mainly found in the manufacturing sector and are discussed in this section. However, scholars conclude that FDI is extremely

country and factor specific (Derado 2013). Croatia's investments may be similar to Slovenia's, but does Croatia have the same investment environment?

In 2013, Deichman came to the conclusion that a relationship with the EU was a determinant of inward FDI to Croatia. Scholars also agree that free access to trade markets is a factor in increasing FDI (Derado 2013; Svejnar 2002). Now that Croatia is a member of the EU, each of the sectors determined by the US Department of Treasury should provide an easier investment process. Both EU countries and countries that already do business with the EU will be more likely to invest in Croatia.

Each year the United States' Department of Commerce issues a "Doing Business In" series that discusses possible market and investment opportunities for the US. Investment opportunities include tourism, telecommunications, medical equipment, boating equipment, energy and technology, along with others. The following sectors have been defined in the series and will allow for further discussion about investment opportunities in Croatia as a result of its accession into the EU.

Croatia is mainly split into two different regions: the beautiful Dalmatian coastline and the interior country, each with its own characteristics and investment opportunities. These two regions play a role in the investment opportunities in Croatia. Without much surprise, the tourism sector provides myriad opportunities, but this leads to another question: Can a country rely heavily on tourism yet still be a major economic player in the European Union? The Croatian government has "committed to moving forward on several pending tourism infrastructure projects" (U.S. Dept. of Commerce 2013, p. 42). In addition, Croatia's accession to the EU makes traveling to the country much easier for Europeans. Croatia is expected to be a member of the Schengen Area by 2015, and then European vacationers will no

longer be subject to border controls and can travel freely to and from Croatia (European Commission 2013). With an increase in tourists from Europe, the government should want to improve the tourism infrastructure to compete with the coastlines of Spain, France, and Italy, the other Mediterranean hot spots. With this improvement, foreign investors may be attracted to build resorts and hotels on the coast, improving the international economic activity of Croatia.

In relation to tourism and the coastline of Croatia, the boating equipment industry provides foreign investors the chance to sell modern tools and marina services. Nautical tourism is also related to the boating industry and the local production of boats is expected to gross \$150 million per year (U.S. Dept. of Commerce 2013). The newly enforced environmental protection standards, as a result of the EU accession, are relevant to this investment. For example, French firms could come into Croatia and provide marina operations and boating repair as this industry booms in an exponentially growing touristic Croatia.

Another result of Croatia being and becoming a more popular tourist destination is a higher demand for seafood. The fishing industry in Croatia cannot meet the current demand, which provides an opportunity for foreign fish and seafood exports. EU countries that have a strong fish market could begin selling their fish to Croatia, again more easily as the country is now a member of the EU, introducing more lenient trade regulations. As the tourism increases in Croatia, so will the demand for seafood, therefore providing a larger market for EU countries that have excess fish and seafood.

Moving away from the coast related industries, energy, telecommunications, medical equipment and pharmaceuticals, and agriculture are other significant

sectors for foreign investment opportunities. Croatia improved and updated its energy sector while applying and working through admission into the EU, as energy is a very important factor for smooth integration into the union. The Croatian government has prepared an Energy Strategy until 2020, in line with the EU energy goals for 2020. The strategy mainly discusses Croatia's "need for increased, diversified, and sustainable supply of energy resources and improved energy efficiency" (U.S. Dept. of Commerce 2013).

As a new member of the EU, Croatia must adhere to new ethical standards, providing an investment opportunity in environmental technologies, including public water supply projects and waste management. Before July 2013, the EU Pre-Accession Assistance Fund IPA mainly funded these projects, but from July 2013 through 2015, \$200 million will be allotted for environmental infrastructure projects. Environmental projects not only increase the economy of a country, but the quality of life. The mixture of economic and environmental standards is important in the EU accession process.

Other standards that changed as a result of joining the EU include medical standards. Croatian distributors are actively searching for medical equipment, food supplements, and health related IT systems (U.S. Dept. of Commerce 2013). This provides another attractive opportunity for other countries to invest in Croatia.

This chapter generally defined FDI in relation to transition economies and outlined prospective opportunities and investments in Croatia. Croatia is ranked 81 out of 144 by the World Economic Forum in International Competitiveness, which needs to be much higher if Croatia wants to actually compete with the major markets in the EU (Crljenko 2014). Although the U.S. Department of Commerce listed areas



where investment can occur, the investment atmosphere in Croatia is nowhere near where it should be. With regard to Croatia's changing market, economists admit that the negative effects in the short-run from leaving CEFTA will be outweighed by the positive effects in the mid-run of joining the 600 million-buyer market of the EU (Ernst 2014). However, solely entering a market does not automatically increase FDI. This chapter introduces areas of investment, but overall, Croatia needs to reform sectors to attract FDI. Ways in which Croatia can increase investment is discussed in Chapter 7. It is left up to Croatia to make these opportunities of *Doing Business in Croatia* attractive to foreign investors and up to the investors to find and utilize the opportunities, aiding both the home country and the host country, Croatia. The purpose of this chapter was to explain the reasons that FDI was included as a main economic indicator of accession into the EU. It also recognizes that although there are investment opportunities, Croatia should focus on improving its investment atmosphere. In conclusion, scholars have generalized that proximity to a free market increases FDI and therefore increases economic growth, but, not without a proper investment climate of the host country.

## **Chapter 4 Unemployment**

Unemployment in transition economies is a very interesting phenomenon. Susic (2005) concludes that “reducing unemployment should be one of the top priorities for the economic policy” in transition economies (71) but an International Labor Organization paper discussing unemployment notes that this “challenge” “requires coherence and coordination across several ministries and labor market institutions” (Gotovak 2001, p. 47). Under communism, state owned industries employed a large number of workers but when these countries switched to free markets, some people lost their jobs as a result of privatization. After communism fell, As well, the state bureaucracy decreased in size, so many government employees lost their jobs. The transition process did create new jobs, but in place of old ones enabled by the Communist government, consequently these new jobs only transferred those already employed, and did not create new jobs (Susic 2005). Transition economies are making their way toward market economies, and those that have joined the EU have made significant efforts to do so. Research done before transition countries entered the EU (first ex-Communist countries joined the EU in 2004) is still prevalent because it provides the background and framework for the situation of the transition countries. Many of the CEEC are still dealing with the problems discussed before accession. EU accession has caused changes in some countries, but transition countries inherently have a more difficult time attracting new

firms to quickly decrease unemployment because of their past economic and governmental policies.

There are two prominent issues in current literature regarding unemployment in transition economies. Although scholars note other factors, the majority of their discussions concern 1) low job creation and 2) a large tax wedge (Rutkowski 2005; Sosic 2005).

A significant cause of low job creation in transition economies is the limited growth of firms, both domestic and foreign, (Rutkowski 2003), as well as poorly organized labor markets and inefficient job centers and job searches (Sosic 2005). These, however, can work together. Increased demand for more efficient job assistance centers can attract private firms to aid in the job search. The *ILO 2013 Country Assessment Report* on Croatia provides analyses of macroeconomic development during the global crisis. Job creation resurfaces as an extremely important factor in decreasing unemployment, which seems obvious, but with all of the other factors involved, is not necessarily easy. Reforming job search assistance creates a demand for more job assistance firms while also helping to decrease the unemployment rate (Sosic 2005). Therefore, people can be employed in the new job assistance firms while helping others to find employment. The ILO comes to this same conclusion almost 10 years later.

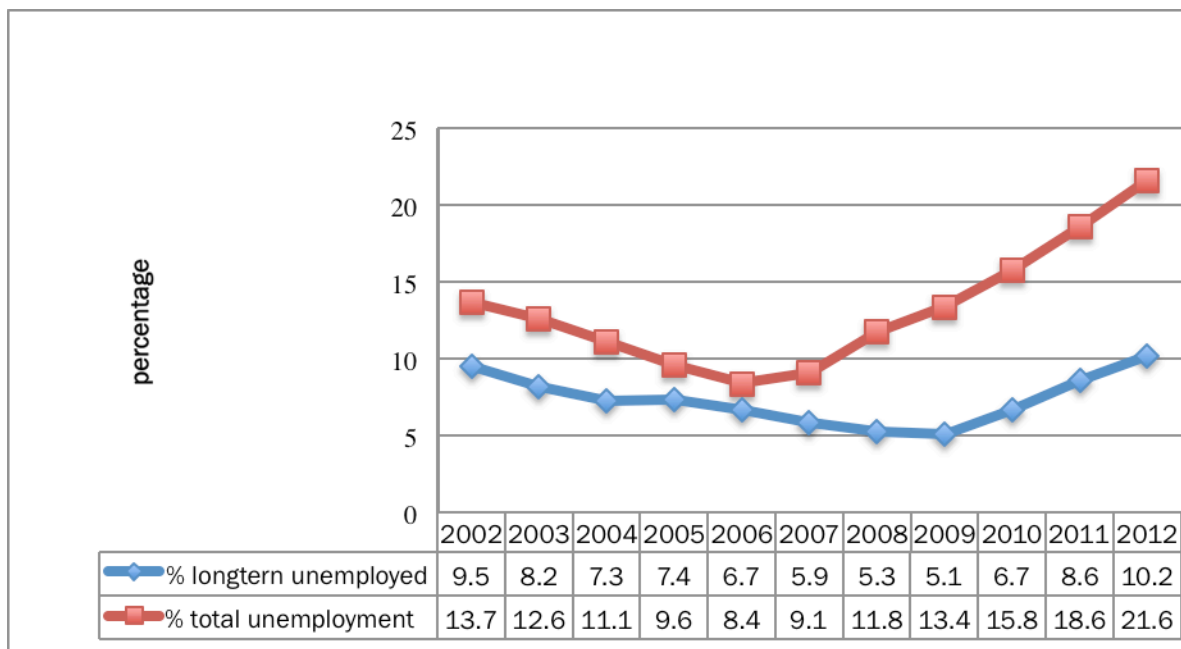
Unemployment has been a problem for Croatia for many years, and a problem that still continues today. The current unemployment rate in Croatia (February 2014) is 21.6 percent (European Commission 2014), about 16 percent higher than an average or safe unemployment rate as established by the IMF. High unemployment, especially high long-term unemployment is extremely detrimental to a country,

particularly developing and transitioning economies that are in the process of trying to become wealthier and compete in the world market. The EU 2020 Targets from the European Commission includes a goal to have 75 percent of the population of 20-64 year-olds employed. Unless Croatia implements new employment plans quickly, as of now this goal seems unattainable. A positive relationship exists between economic growth and employment. When the economy is stable and growing, production increases and jobs are plenty, while in economic depression, production decreases and therefore the workforce decreases.

See Figure 4.1 showing long-term unemployment rate compared with the total unemployment in Croatia (World Bank 2013j, World Bank 2013k).

**Figure 4.1**

**Long Term vs. Total Unemployment in Croatia**



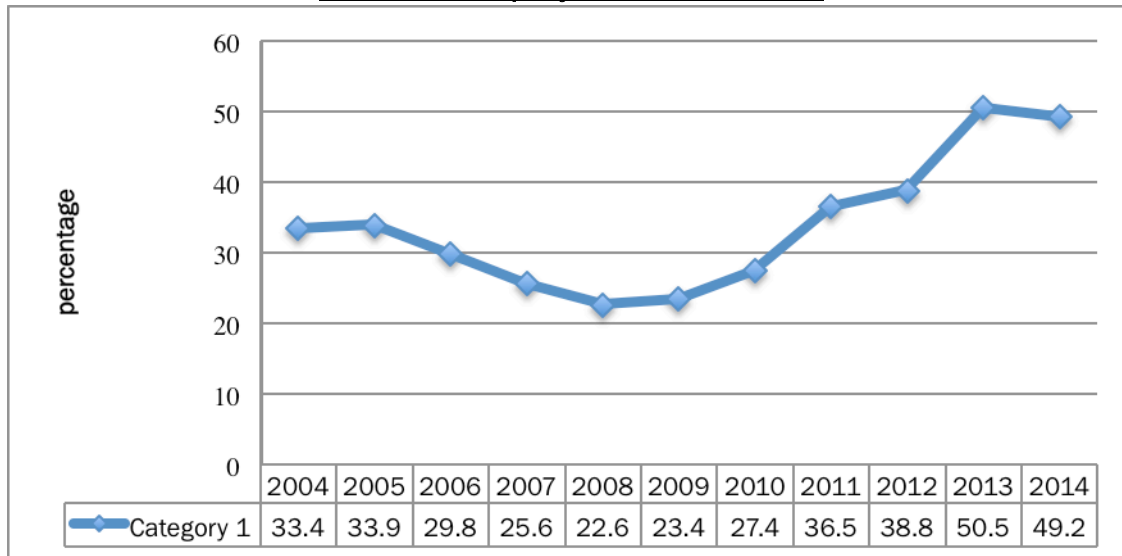
Source: World Bank Long Term/ Total Unemployment 2013;  
<http://data.worldbank.org/indicator/SL.UEM.LTRM.ZS>; Author's Chart

Since Sosic (2005) and Rutowski (2003) have discussed unemployment in transition economies, Croatia has gone through the EU accession process and there has been a major global recession, two factors that are important in discussing further unemployment in transition economies and specifically Croatia, but many issues still remain the same. Figure 4.1 shows the increasing percentage of both the total unemployment and long term unemployment. The ILO suggests that increasing job creation by combining education and work experience with greater job search assistance can help unemployment (2013). It is imperative to note that this alone will not solve the problem of high unemployment; it merely gives an example of how much needs to be done about unemployment in Croatia. Other policy changes include budgetary policy, the supply and demand of skills, and unemployment benefit program.

Unemployment statistics in Croatia are actually quite scary. The youth unemployment rate (ages 15-24) is extremely high, an alarming 49.2 percent (February 2014) (European Commission 2014). Figure 4.2 summarizes the youth unemployment rate in Croatia during a ten-year period, 2004-2014. This time period is interesting because it includes Croatia's accession negotiations, the global recession, and Croatia's admittance into the EU.

**Figure 4.2**

**Youth Unemployment in Croatia**

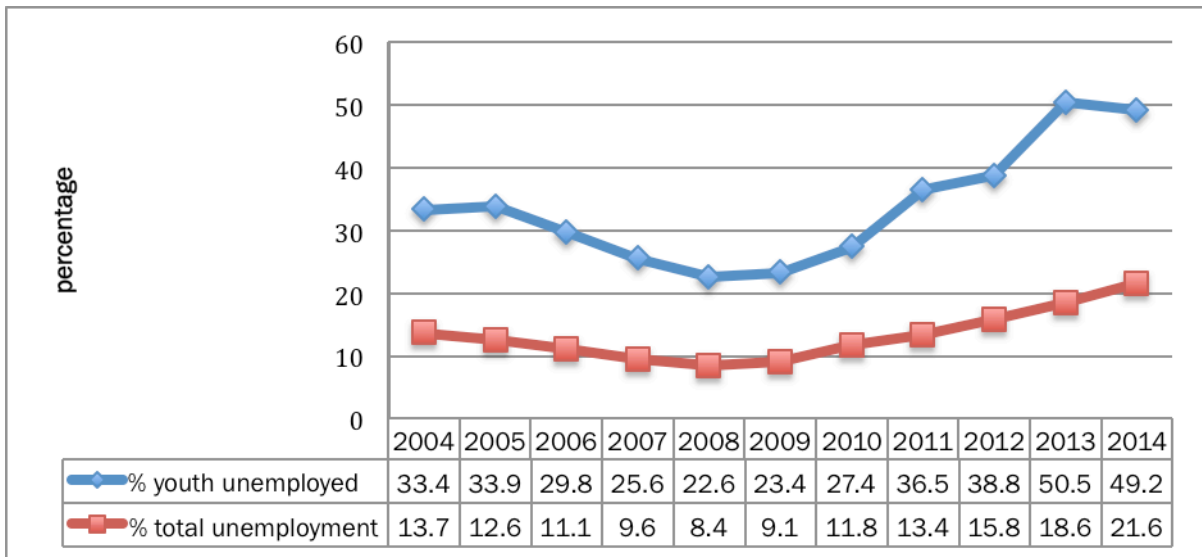


Source: World Bank Youth Unemployment Data 2013;  
<http://data.worldbank.org/indicator/SL.UEM.1524.ZS>

The above numbers are not promising for the youth of Croatia. A youth employment rate of 49.2 percent is a major impediment for economic growth and it is vital that Croatia makes strides to decrease youth unemployment to ensure that these employees are employed in the future. The huge (11.7%) increase in unemployment from 2012 to 2013 exemplifies the uphill battle that Croatia is facing with regards to youth unemployment. The following chart shows the relation between youth unemployment and total unemployment in Croatia.

**Figure 4.3**

**Youth vs. Total Unemployment**



Source: World Bank Unemployment Data 2013; <http://data.worldbank.org/indicator/SL.UEM.TOTL.ZS>;  
Author's chart

The percentage of youth that is unemployed is significantly higher than that of total unemployment. If this high rate of youth unemployment continues, it will be very difficult for Croatia to grow economically. The youth are the future of the country, and if they cannot find jobs, what does that say for the future of Croatia and its economy? The total unemployment rate is also extremely high. However, due to the recent global crisis, is similar to that of other EU countries.

To put things into perspective, an article in the *New York Times* in June of 2013, which was just a few weeks before EU accession, mentions the story of a wall of graffiti in downtown that reads: “*Young ones, leave Croatia*” (Bandic and Stojanvic 2013). This shows the negative outlook that many Croats have on EU integration. With a youth unemployment rate of just under 50 percent, and when work restrictions expire, experts are nervous that the young and educated will leave to

other EU countries to find jobs. Even with easier access to other European countries, Croats may not want to move to a different country because of those countries' current economic conditions (for example, Spain and Greece have unemployment rates near 50%) (Bandic and Stojanovik 2013). This still may lead to a *brain drain*.

A *brain drain* is a serious issue that affects employment. It was first termed in England in the 1960s when a large number of scientist and technologists moved to the United States and Canada. In broad terms, the educated work force moves away from their home country, or as stated by Beine et al., the "migrations of people endowed with a high level of human capital" (Beine 2001, p.275). Although there are several definitions of a brain drain, all suggest that the movement of these endowed goes from poorer to richer countries (Giannocolo 2009). This migration causes the sending country's economy to stagnate because the people who are the most qualified for jobs and who have the initiative to change the country are no longer there to do so. This can have dramatic effects on the economy, as studies show that migrations have a negative effect on the growth and welfare of the countries whose citizens are leaving. Giannocolo (2009) traces the consequences of a brain drain for the sending country from the 1950s to 2000s, all which have negative effects and cause a larger gap between lower-developed countries and higher-developed countries. If history repeats itself, Croatia could be faced with a *brain drain* and experience economic decline because of it. Because Croatia is now "closer," if you will, to richer European countries, skilled and educated workers may be more likely to migrate, especially because of the low job opportunities in Croatia. But if these workers will receive a higher income in a different country, then why not move? Croatia is at crucial point in determining its success in EU. Experiencing something



that has proven to result in a decline in growth and welfare would make successful economic succession into the EU more difficult.

Krunoslav Ostojic, 43, an unemployed German-Croat who has had multiple unstable jobs moved to Germany after July 1, 2013 (date of accession) to work for a German roofing company (Pauly 2013). This provides an example of how easier access to other countries improves the unemployment and life of one Croatian citizen, but this job is in Germany. It is beneficial for Croats to find jobs in other EU countries, but it is even more beneficial for Croatia to create stable jobs at home.

In conclusion, the data shows disturbing numbers for Croatia in regard to unemployment, specifically with regard to the youth. This will provide major problems in the future if it is not dealt with. In a later section, Croatia's unemployment will be compared to other countries in the EU. An increase in the employment rate is a sign of economic growth as more jobs are being created, but at the rate that Croatia is going, economic decline based on unemployment is in the near future. Although negatively, this section explains how unemployment is a factor in Croatia's accession process. It is a factor that must be controlled by implementing labor reforms and creating new jobs, but a factor that can determine the future of a country in hopes of experiencing economic growth in a new market.

## **Chapter 5 Infrastructure**

Infrastructure is the basic structure of a country that provides movement and development. It includes variables that contribute both economically (transportations, energy) and socially (hospitals) to a country. Infrastructure is one of the main indicators of development in a country. Developing countries are in desperate need to create an infrastructure to improve their economy. In a World Bank Discussion Paper *Decentralizing Infrastructure*, Bird (1995) concludes, “infrastructure investments almost invariably constitute the core of both national and regional development in most countries” (22). Both developing and transition countries are in need of infrastructure reform, whether it be providing a start of infrastructure or improving the efficiency of the already-established infrastructure. Improved infrastructure can determine economic success, help reduce poverty, and improve and expand cultural advances (Bird 1995).

The difference between developing countries’ infrastructure and transition countries’ infrastructure compared to that of developed countries is distinguishable for two reasons. The first is that developing countries rarely have infrastructure, while transition countries have infrastructure, though it just might not be as efficient as in developed countries. The second is the policy under which the infrastructure was formed. In transition economies, the central government controlled all infrastructure and prioritized production for the masses, not necessarily efficiency or environmentally safe standards. The privatization and decentralization of

infrastructure has been a common topic of research since the transition period. Research has shown that although central planning was capable of providing infrastructure, it may not have been as effective as that of a market based economy (Harvey and Myers 1999; Carbajo and Fries 1997; Bird 1995). Research has also shown that infrastructure in transition economies must be reformed to attract new investment, more effective management, and more efficiency. A significant amount of research deals with the relationship between infrastructure investment, the public sector, and economic growth of the country. Scholars also agree that countries that have made their way to a free market and implement infrastructures of a free market will behave stronger on a global economic level (Rotowski 2003; Harvey and Myers 1999).

Infrastructure includes many different sectors. This paper will mainly deal with economic indicators of infrastructure such as transportation (roads paved, railroads), energy, and telecommunications (strong relationship to FDI). These sectors of infrastructure provide both government-required action and opportunities for increased privatization and investment. Previous research provides a basis of their importance. Humplick and Estache (1995) performed a study of the effects of decentralizing infrastructure. Their study yielded the following results: 1) There is an increase in paved roads and a performance overall; 2) The generation capacity improves and the tariffs are lower for electricity; and 3) the percentage of water loss decreases. This section aims to look at paved roads and electricity in Croatia. The second study that I am basing the choice of infrastructure in Croatia on is the study of Harvey and Myers (1999), which measures the relation between infrastructure and income and how public spending relates to economic growth. The sectors of their

study were transports, communications, and energy supply. Transports and energy were recurring measurements in other literature regarding infrastructure in transition countries as well, which is why they are included in this study of Croatia. These were also chosen because of their importance to the relation between Croatia and other countries in the EU. On an elementary level, Croatia cannot be in the same league with a country such as the United Kingdom if it does not have the roads necessary to move its products. Croatia received loans from the World Bank and European Bank for Research and Development (EBRD) during its civil war from 1991 to 1994. The funds were used to improve infrastructure, including transportations, electricity, and water supply, among other areas of need.

This section will compare indicators of infrastructure in Croatia over 20 years in intervals of five years (1990, 1995, 2000, 2005 and 2010). These years will show change (or no change) one year after Croatian's independence from Yugoslavia, right before accession negotiations with the EU, and right before Croatia became a member of the EU. These time choices should provide an example of infrastructure in a transition economy, as well as paint a picture of infrastructure in Croatia, as it is the main country of focus throughout this paper. Effects of decentralization are not and cannot be the same for every country because they are "sector and country specific" (Humplick and Estache 1995) so this will not generalize decentralization of infrastructure for all transition countries, but will provide an example to see how things may have changed and may present a base for what the future of infrastructure in Croatia and other transition countries will look like.

Table 5.1

Infrastructure in Croatia

	1990	1995	2000	2005	2010
Energy	2965	2290	2856	3476	3814
% Roads paved	*	81.5	85.4	*	90.7
Telephones	822,988	1,287,061	1,721,139	1,882,500	1,639,977

Source: World Bank Data Indicators 2013; <http://data.worldbank.org/indicator>

The first indicator that will be discussed is the number of roads paved, as it is fairly straight-forward and supports the literature that transportations, particularly percentage of roads paved, increases as a country goes through transition to a market economy. The number of roads paved in Croatia has risen about ten percent in ten years. There is a direct positive relationship between transitioning from a centrally planned economy and increasing the number of paved roads in a country. Decentralization results in better overall performance of roads and better conditions of unpaved roads (Humplick and Estache 1995).

Increased transportation systems have positive effects on many areas of the economy. Advanced highway systems benefit trade, which in turn benefits the economy as a whole. This year, the EU has set aside \$860 million (1.5 percent of the country's GDP), for Croatia (Pauly 2013). There is now a new minister in Croatia who is in charge of distributing the EU funds. It is projected that much of this aid will be used for infrastructure projects, including renovating railroad lines and new sewage treatments. One specific projected infrastructure project is a bridge that crosses over the Adriatic Sea. Dubrovnik, a coastal city, is separated from the rest of the country by Bosnia-Herzegovina, so Croats wishing to travel to and from Dubrovnik must do so

twice through an external EU border (Pauly 2013). There is hostility between Croatia and Bosnia, and the bridge would not only create easier access to this popular destination but it would also take out the border control process in Bosnia.

This study recognizes that Croatia is no different from a standard transition economy with an increased number of paved roads after transition, but other data shows that Croatia is a leader in the road-sector of transportations of transition economies. This is important in improving their business and trade climate within the EU, and if used to its full potential, could be a comparative advantage for Croatia. The Croatian road network consists of 29,333 kilometers of categorized roads, which is the longest in Southeast Europe (Erste 2014). A strong road network is vital for trade and Croatia has sufficient roadway infrastructure, both nationally and locally funded, making it more attractive to international business.

Although this study compares the percentage of roads paved in Croatia over time, it is not the only sector involved with transportation infrastructure. Another important aspect of transportation infrastructure is the railway network. The railway network in Croatia is not very extensive, which leaves room for improvement and investment, particularly because there has not been much investment in Croatia's railways since the breakup of Yugoslavia. In addition, there are very few railways along the coast. If coastal tourism remains an important economic sector for Croatia, improving the coastal rail network would increase travel access and ease to this region. Inland networks are already in place, but the implementation of high-speed railways and reconstruction of old lines would increase the efficiency and add another important sector of transportation infrastructure in Croatia. Transportation

infrastructure in Croatia outlines a possible road toward more economic success, as does another sector of infrastructure in Croatia, telecommunications.

Telecommunications includes phone lines, fax machines, Internet, any sector that involves communication. This research focuses on one sector: phone lines. Research concludes that investment in telecommunications is crucial in transition economies. Unsurprisingly, there was an increase in the number of telephones in Croatia during the early transition period from 1990 to 1995 and again an increase from 1995 to 2000. As seen in Table 4.1, there was a slight increase from 2000 to 2005 but a fairly noticeable decrease from 2005 to 2010. This is most likely explained by an increase in cellular devices. This leads to Croatia's advancement as a leader in telecommunications in Southeast Europe. The increase in telephone lines shows economic advancement after transition and the increase in cellular devices shows technological advancement.

Telecommunications is an area in which Croatia is a leader for Southeast Europe, with all lines being completely digital. The Erste National Bank (2014) deems Croatia the most modern in Southeast Europe. The telecommunications sector in Croatia is liberalized with operators in landline and mobile telephones. 66% of Croats have Internet access. This is lower than EU average but higher than some individual countries, the majority being other transition economies, again showing Croatia's advances in infrastructure as a transition economy. Telecommunications is an extremely vital sector in today's global economy. Although Croatia is a leader in its geographical region, improvements can be made to compete in the EU market.

The final sector of infrastructure that will be discussed in this paper is energy.

Under central planning, there was wasteful consumption of energy and more energy per kilowatt was used than under a market-oriented economy. (Carbajo and Fries 1997, p. 8). The other significant issue with energy under central planning was the massive negative effect on the environment. Croatia implemented changes in their energy policies as suggested during EU accession negotiations. The EU highly values environmental standards and Croatia has worked to make sure they meet these standards. By 2020, the government plans to have a 20% decrease in greenhouse gas emission (Republic of Croatia Ministry of Economy 2009) in coherence with the EU Energy standards.

The World Bank defines electric power consumption as measuring “the production of power plants and combined heat and power plants less transmission, distribution, and transformation losses and own use by heat and power plants” (World Bank 2013b). The data collected on energy is measured in kWh per capita. Energy consumption remains fairly steady from 1990-2010, with a decrease in the early transition period from 1990 to 1995, but then increases steadily. This can be explained by the typical centrally planned economy using a large amount of energy for mass production. Energy development and growth are just as important as efficiency for economic and social development (Republic of Croatia Ministry of Economy 2009), which is why Croatia should continue to expand their energy sector. The Republic of Croatia Ministry of Economy concludes “regardless of the actual world crisis, there is a significant interest for investments in Energy sector” (p. 103). This provides another example of how infrastructure can increase FDI to Croatia.

This chapter supports the existing literature suggesting the importance of that infrastructure in development. Without sufficient and efficient infrastructure,



economies cannot easily grow. The data shows that energy, roads, and telephones are all on par with transition into a free market economy, and that Croatia leads its region in some aspects of infrastructure. Croatia's advances in infrastructure provide opportunities in other sectors of the economy including foreign direct investment and employment, the two other indicators discussed in this paper. Improvement in infrastructure benefits the economic status of a country and strengthens the business climate. Being a leader of Southeast Europe in some aspects of infrastructure does not make Croatia the leader in the European Union; however, it allows for Croatia to utilize and improve on the infrastructure it does have to increase economic activity and attract international business as a new member of the EU.

## **Chapter 6: Country Comparisons**

This section discusses the “average” EU country and divides the EU into three groups of countries. The groups were determined by GDP per capita in 2012 of each EU country. They are labeled as high income, middle income, and low income, all relative to each other as the 28 members of the EU. Group 1 (higher income) are countries that have a GDP per capita in 2012 of United State’s dollars (USD) of \$30,000 or higher. These countries are: Luxembourg, Denmark, Sweden, Austria, the Netherlands, Ireland, Finland, Belgium, Germany, France, the United Kingdom, and Italy. Group 2, (middle income) includes those countries with GDP per capita of USD \$15,000 to USD \$30,000. Spain, Cyprus, Greece, Slovenia, Czech Republic, Malta, and Portugal make up Group 2. Group 3 (low income) consists of Lithuania, Latvia, Croatia, Poland, Hungary, Romania, and Bulgaria; all have a GDP per capita of less than USD \$15,000. Table 6.2 outlines the countries separated into their respective groups.

**Table 6.1**

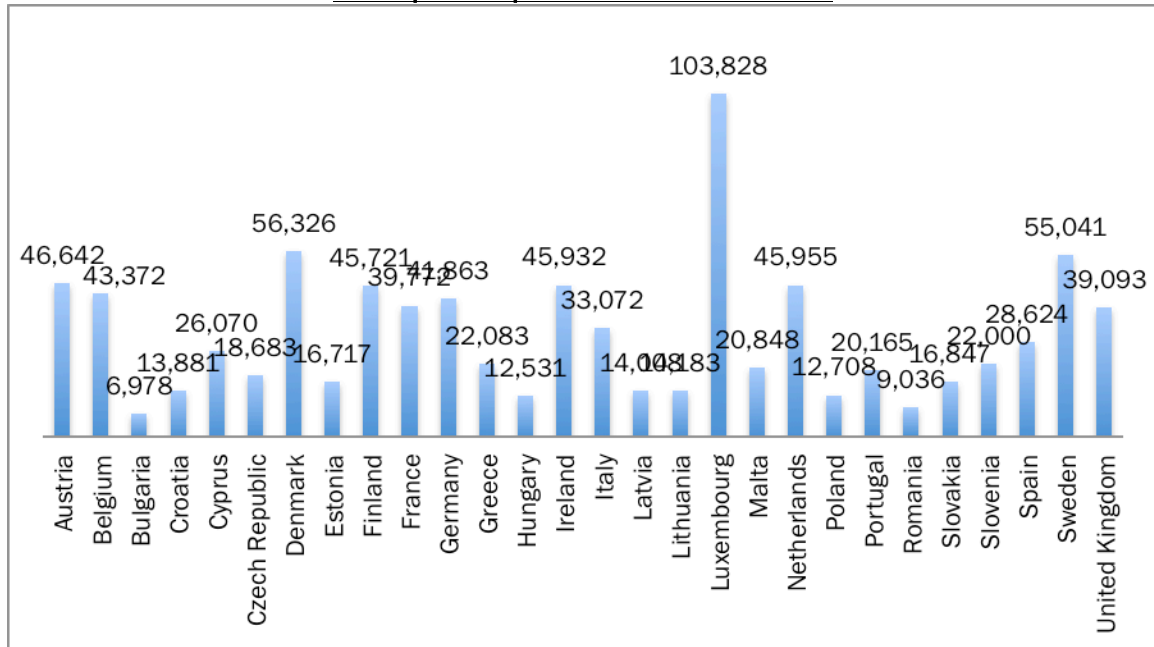
**GDP per capita of EU Countries**

<b><u>Country</u></b>	<b><u>GDP per capita</u></b>
Austria	46,642
Belgium	43,372
Bulgaria	6,978
Croatia	13,881
Cyprus	26,070
Czech Republic	18,683
Denmark	56,326
Estonia	16,717
Finland	45,721
France	39,772
Germany	41,863
Greece	22,083
Hungary	12,531
Ireland	45,932
Italy	33,072
Latvia	14,008
Lithuania	14,183
Luxembourg	103,828
Malta	20,848
Netherlands	45,955
Poland	12,708
Portugal	20,165
Romania	9,036
Slovakia	16,847
Slovenia	22,000
Spain	28,624
Sweden	55,041
United Kingdom	39,093

Source: World Bank GDP Data 2013; <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD>

**Figure 6.1**

**GDP per capita of EU Countries**



Source: World Bank GDP Data 2013; <http://data.worldbank.org/indicator/NY.GDP.PCAP.CD>

**Table 6.2**

**Break-up of EU Countries**

Group 1 (> \$30,000)	Group 2 (\$15,000-\$30,000)	Group 3 (<\$15,000)
Luxembourg	Spain	Lithuania
Denmark	Cyprus	Latvia
Sweden	Greece	Poland
Austria	Slovenia	Hungary
Netherlands	Malta	Romania
Ireland	Portugal	Bulgaria
Finland	Estonia	
Belgium	Czech Republic	
Germany	Slovakia	
France		
United Kingdom		
Italy		

Source: World Bank Indicators 2013; <http://data.worldbank.org/indicator>

Croatia will be compared to the averages of each economic indicator for each group (see Table 6.2). From GDP per capita, it has already been seen that Croatia is in the lower-income group of countries relative to EU GDP per capita. The remainder of this section reviews other indicators and how Croatia compares in relation to them.

The indicators include mostly economic sectors. They are the three main economic sectors of this paper: unemployment, foreign direct investment, and infrastructure, as well as GDP growth, current account balance, inflation (GDP inflator), total labor force, and central government debt (% of GDP). These indicators will paint a picture of the atmosphere in each of the three groups. Croatia will be taken out of Group 3 of the groups determined by GDP per capita, as it is the country of the study. All data was taken from the online World Bank Indicator database (2013).

The comparison will be conducted as follows: Croatia will be compared to the average of each indicator of all EU countries and the average for each group. The average for the total EU will be the total amount of each respective indicator divided by 27, since Croatia is being left out of the equation. The average for each group will be the total divided by the number of countries in the group (Group 1:12; Group 2:9; Group 3:6). See Table 6.3 for average numbers.

**Table 6.3**

**Group Averages**

<b>Name</b>	<b>GDP per capita</b>	<b>Current account balance</b>	<b>Inflation</b>
Croatia	13,881	-208,098,762	2
EU AVG	39,619	7,588,342,803	1.54
Group 1 AVG	49,718	17,871,422,553	1.69
Group 2 AVG	21,337	-3,183,017,013	1.02
Group 3 AVG	11,574	-4,009,757,220	2.17

<b>Name</b>	<b>GDP growth</b>	<b>Unemployment</b>	<b>FDI</b>
Croatia	-2	15.8	1,395,251,519
EU AVG	0.275	9.455	14,332,883,995
Group 1 AVG	-0.133	7.825	17,129,681,127
Group 2 AVG	-1.155	13.644	7,397,485,275
Group 3 AVG	2.116	11.4	3,637,642,054

Source: World Bank Data Indicators 2013; <http://data.worldbank.org/indicator>; Author's calculations

In looking at GDP, Croatia falls into the “lower income” EU countries with a GDP per capita of \$13,881. However, it is above the average of Group 3, which is \$11,574. These numbers are both significantly lower than the average of the EU as a whole. Most of the countries in Groups 2 and 3 are transition economies that still need to experience economic growth to reach a higher level of GDP. However, some members of Group 2 are countries that have experienced extreme decline as a result of the economic crisis in 2008 (ex. Greece, Portugal, and Spain). Studies show that all transition economies had declines in output at the beginning, but made a turn

around in three to four years later (Svejnar 2002). However, in 2001, Poland was the only country to make a large jump in the income gap between advanced OECD countries from low to no growth during transition (Svejnar 2002). All of these countries have become members of the EU since this transition period.

Croatia again falls into Group 3 in its level of inflation. The level of inflation in Croatia is 2, above the average of the EU but lower than the average of Group 3. Transition economies experienced high levels of inflation at the beginning of the transition period, and these numbers have dramatically decreased as a result of speedy macroeconomic reforms (Svejanar 2002). Transition economies experienced inflation from 200 percent (Poland, Slovenia, Albania, Bulgaria, and Romania) to above 2000 percent (Russia, Ukraine, and Kazakhstan) in at least one year from 1990-1993 (Svejanar 2002). However, those countries reaching over 2000 percent are not in the EU. There were, however, transition countries that are current EU members that experienced inflation around 1000 percent (Estonia, Lithuania, and Latvia) (Svejanar 2002).

GDP growth provides interesting results. Croatia's GDP growth, or decline in Croatia's case, in 2012 was -2, while the average of the EU was .27. Groups 1 and 2 both have negative GDP growth, while Group 3, the lower-income EU countries, has an average positive growth.

The severity of Croatia's unemployment was previously discussed in Chapter 3. In 2013, the unemployment rate was 18.1. %. Being seven points higher than the EU average of 11.1%, unemployment proves to be a hindering factor in Croatia's economy (European Union 2013). Unemployment will be discussed in more depth in the conclusion and implications chapter.

Croatia falls behind in FDI inflows as well. This makes sense, however, as Croatia is the newest member of the EU so has not had access to more easily invested enterprises. Croatia's FDI inflow is millions below that of the average of all of the EU countries. FDI is crucial to increase economic growth. In the earlier chapter on FDI, this paper discussed the positive factors of Croatian FDI, but when compared to other countries of the EU and how lacking Croatia is, that hypothesis takes a more negative turn regarding the impact of FDI. Meaning, if FDI does not increase in Croatia, it will have a difficult time adapting and growing with high-income EU countries. It has not been a year since Croatia joined the EU, but the conclusion can be made that Croatia must reform and try to make their investment atmosphere more attractive.

**Table 6.4**

**Croatia's Comparisons**

	Group 1	Group 2	Group 3
GDP			X
Inflation			X
Unemployment		X	
FDI			X

In regards to GDP, inflation, and FDI, Croatia is closest to Group 3, the lowest income group of the EU. However, in both GDP and inflation, Croatia is higher (lower in the case of inflation) than the average Group 3 member, signifying that Croatia is in a better state than some countries in Group 3 with regard to GDP and inflation. This slightly positive result signifies that Croatia is economically better off (with



regards to GDP and inflation) than some of the countries in Group 3. However, it still falls far behind that of the average EU and even the numbers of Group 2 in some cases.

Croatia is similar to Group 2 in relation to unemployment. In fact it has a higher unemployment rate than the average of Group 2. This shows that Group 2 struggles more with those issues, as Croatia ranks extremely poorly. It is interesting that these middle-income EU countries have a higher average unemployment rate. Reasons could include countries in Group 2 such as Spain, Portugal and Greece that are experiencing economic decline as a result of the global economic crisis. Their unemployment rates of 25 percent, 24.2 percent and 15.6 percent, respectively, raise the average of Group 2. This does not take away from the fact that Croatia has an extremely high unemployment rate. The other countries in Group 2, Cyprus, Slovenia, Malta and Estonia also rank lower in unemployment.

Even though Croatia is more similar to Group 2 in some aspects and more similar to Group 3 in others, Croatia struggles in these economic indicators. Though it is above the average of Group 3 in GDP and inflation, the remainder of the indicators reveals Croatia is nowhere near the numbers or levels of the major economic competitors in the EU. This is as to be expected, as it is the newest member of the EU and a transition economy. However, it does provide insight in the areas where Croatia can improve. In conclusion, Croatia has the most similarities with Group 3, the group with the lowest average income. This is perhaps to be expected, but it is still beneficial to analyze the problems that Croatia has along with the rest of transition countries in the EU. The data show that unemployment and FDI are the areas where Croatia falls short and that they are the largest impediments to the economic growth

of Croatia in the EU relative to the other chosen indicators of this research. The final section will further conclude the comparisons and discuss the implications of the results for the country as a whole, its citizens, and international and local business in Croatia.

## **Chapter 7: Managerial Implications**

Many people, including Croatian officials and economists along with international leaders, have noted that the outlook for Croatia is not particularly bright. Initially, it does seem as if all signs should point to accession into the EU as an extremely positive step, with a larger market, free movement, and other benefits. However, Croatia has been in economic recession for the past five years. This fact along with the lack of a large amount of investment opportunities and scarce job opportunities scare not only politicians and economists, but Croatian citizens as well.

Neither Croatian nor EU officials think that Croatia's economy will immediately change. Croatia's National Bank Governor Boris Vujcic relays that "Croatia will feel the benefits of EU entry in three to five years. In the short term, nothing major will change." EU Enlargement Commissioner Stefan Fule has the same message. ".. do not expect dramatic changes overnight. Croatia will not be a different country on 1 July than it was on 30 June" (Bandic and Stojanovik 2013).

If these suggested problems do happen, there will be many implications for Croatia. Croatia, in terms of the data analyzed, is currently better off economically than Bulgaria and Romania, which is a good sign as these two countries have had economic difficulty in their accession into the EU. However solely having better statistics than two countries does not automatically allow Croatia to be a successful member of the EU.

Croatia's path as the newest member-state of the EU is not only important for the success of Croatia-itself, but for the future of the entirety of the European Union. If Croatia does not increase FDI and decrease its unemployment rate, and in return not experience any economic growth, will that lead to stricter reforms before EU accession for other countries? Croatia's success or failure could possibly lead to a decline in the speediness of other countries' negotiation processes. The remainder of this section will discuss implications for other countries' EU involvement, Croatia, local businesses, and international firms doing business in Croatia.

If Croatia does not experience high economic growth as a new member of the EU, the countries going through negotiations, such as Bosnia-Herzegovina and other ex- Yugoslav countries may have a more difficult time becoming new members. The EU might be hesitant to proceed with negotiations if the latest addition does not bring benefits for either the EU or the country. On the other hand, the countries may feel changing their policies and market behaviors to meet EU standards will not be worth their time if they think they will not grow as a member of the EU. There is negative conversation following the most recent EU enlargement before Croatia, that of Bulgaria and Romania, who joined in 2007. These countries still have unstable government and massive corruption issues; some are hesitant about their success in the EU. "The received wisdom about Romania and Bulgaria is that their admission was premature;" said Dimitar Bechev, senior policy fellow at the European Council on Foreign Relations "If Croatia is seen as a success it can bolster enlargement" (Castle 2013).

Implications for citizens of Croatia include both social and economic factors. Individual wealth cannot grow unless the economy as a whole grows. The morale of

citizens will go down and might begin to not support EU relations, making it more difficult for citizens to agree with and cooperate with government decisions based off of EU policies. In 2004, near the beginning of EU negotiations with Croatia, 24% of Croats surveyed by Eurobarometer reported that EU accession was a “bad thing”. By 2012, that number increased to 32% (Europa 2012). At the beginning, the negativity could be based on a lack of knowledge and stereotypes about the EU and the current global and local economic status. This not so overwhelming majority in support of EU accession could also play a role in Croatia’s path of accession. If the citizens do not feel as if they are benefiting from EU membership, they will be more likely not to support and be positive about any further policy changes.

To restate the main findings of the comparison of Croatia to other countries, unemployment and FDI prove to be the largest obstacle to success as determined by this paper. Both of these can have major effects on the local business market in Croatia. If there is not a large presence of FDI, Croatia will have to produce goods and services themselves. Although FDI brings more competition, local businesses would benefit from an international presence.

The success of Croatian businesses looking for an inroad into the global marketplace also depends on their actions as the newest member of the EU. If the Croatian market as a whole becomes competitive with large international firms then local businesses can also grow, boosting the economy even more. If Croatia becomes a haven for international investors, their local businesses will be introduced to the international market. If the relationship with international businesses stagnates, then it would be very difficult for Croatian firms to make a name for themselves internationally. Croatian policy makers should realize the importance of their firms

growing as well as attracting foreign investors. Croatia must build a reputation to attract foreign investors. This cannot just happen overnight. FDI is a significant factor in boosting the economy of a country and it is crucial that Croatia takes major strides in improving its investment atmosphere.

Although unemployment and FDI are obstacles in Croatia's economy, the following sectors encourage an increase economic growth. There are other sectors that Croatia can focus on to improve their economy including tourism, agriculture, and international trade in relation to maritime infrastructure. These will not be discussed in depth but are mentioned to provide an outlook on other sectors of the Croatian economy that were not discussed in a separate individual chapter. Although the main economic indicators discussed in the paper are FDI, infrastructure, and unemployment, it is crucial to note that Croatia does have other sectors in its economy that are generally positive for economic growth within the EU.

Although it is not likely for a country to become a major economic player in a market based on tourism, this is one area where Croatia can really grow as a new member of the EU, attracting around 10 millions tourists per year, 11.8 million in 2012 (Crljenko et al. 2014). Europeans value their vacation time; Spain and Germany both enjoy 34 days of paid vacation each year (Davis 2013). European travelers now have a new, beautiful Adriatic coast destination without the hassle of customs and border control. With these restrictions being lifted because Croatia is a member of the EU, Europeans will have an easier time traveling to Croatia. Croatia should use this to its advantage instead of it just being an extra benefit of EU accession. The tourism industry can boost a country's economy, especially with regard to the three economic factors discussed in this paper: FDI, unemployment,

and infrastructure. Tourism can improve all three of these situations in Croatia. International firms can move into Croatia and build hotels, resorts and restaurants, improving infrastructure and increasing FDI. These hotels and resorts must have employees so more local Croatians would benefit and decrease the unemployment rate. Although seasonal and dependent on the travel choices of others, tourism could seriously improve the economy of Croatia, or at least somewhat improve the status of the three economic factors discussed in this paper. Even a slight boost in economic growth would be an incentive to continue improving the investment opportunity atmosphere in Croatia.

Agriculture is another sector besides tourism where Croatia can grow. Although modern day economic development leans toward a more service-based economy, agriculture plays an important role in the economy of Croatia. Agriculture accounts for 5% of GDP (World Bank 2013a), but a significant number of Croats are employed in the agriculture and food industry (15,000 employees) (Erste 2014; Crnkovic 2014). However, despite favorable climate conditions, Croatia experiences low levels of production. Croatia is self-sufficient in only potatoes, poultry meat, eggs, corn, wine, sugar, and wheat, resulting in the net importation of the majority of agriculture products (Crnkovic 2014). Increasing production would strengthen the economy and increase the number of employees in the agriculture and food sector, helping to decrease unemployment. Due to the Stabilization and Association Agreement, Croatia imports duty free from the EU market resulting in favorable trade conditions; however, increase in exports would better benefit the economy.

Chief Economist of Erste Bank in Croatia, Alen Kovac, states that Croatia's geographical position is a significant comparative advantage (Erste 2014). Croatia

should focus on its 350 ports to increase international trade, and EU funds are predicted to go to strengthening maritime infrastructure. Combining Croatia's favorable geographical location with more production would boost international trade. One of Croatia's major industries is shipbuilding, another significant factor relating to ports. Focusing on increasing production of ships would also encourage international trade. Improving these areas would create more jobs and make Croatian industry more attractive, therefore increasing employment and improving the foreign direct investment atmosphere.

Out of the three indicators, infrastructure provides the most positive results in Croatia. Leading Southeast Europe in transportation and telecommunications, Croatia has the ability to use advances in infrastructure to its advantage within the EU. Infrastructure is also related to the two other indicators discussed, FDI and unemployment. Many foreign investments are made through infrastructure projects, and infrastructure projects create jobs. As noted in Chapter 5, infrastructure proves to be a leading economic sector in Croatia. Increasing investment to this area, especially in areas of transportation, telecommunications, and energy will help Croatia grow as the newest member of the EU.

There are also managerial implications that can be taken from this research. It is important for firms to act based on their market and implement actions that allow the business to thrive in the country's economy. The management of firms is different in each country and now that Croatia has been introduced into a new market, firms should evaluate how they are managed to make sure that they are efficient and productive, along with being able to interact and compete with modern international businesses throughout the world, and particularly within the EU. The



different functions of a business can all be affected by the accession into the EU. These functions include but are not limited to management, accountancy, marketing, and finance. A brief section follows relating the functions of management, marketing, and accountancy to Croatia.

There are a number of different types of managers that can be found in a multinational corporation (MNC), including both nationals and foreigners. A possible change in the management of Croatian firms would be bringing in and hiring more inpatriate managers. Inpatriate managers are skilled global business people who are brought into a country to better manage a multinational firm that does business with that manager's home country. If other Europeans come to Croatia to manage firms, those firms would be more competitive in the global marketplace. In addition, further training of Croatian managers, possibly by other EU countries, would allow for the Croatian managers to better understand how the firms they are now more closely working with and competing with work. FDI has been determined as an indicator of Croatia's success in their accession into the EU, and with more managers who efficiently manage MNCs, FDI could possibly improve with this small change of improvement in managers of firms.

Marketing is another important function to consider when looking at Croatian firms in a new global market. Managers should strengthen their marketing and public relations to a larger market with the new accession into the EU. Croatian firms would benefit from expanding their local businesses to other countries or at least selling more products outside of the EU. If a needed market were to be discovered, the marketing of that firm would need to change to appeal to the new market. Croatia is at an interesting crossroad between their old and new markets, from other ex-

Communist European countries to the more centralized free trade zone of the EU. This movement results in a pressure for changes in marketing to better suit the members of the new market of Croatia. Marketing directors should try to not only appeal to Croats, but to the EU as a whole. In addition, if there is a boost in tourism in Croatia as a result of EU accession, marketing directors will also have to aim their businesses to tourists.

Accountancy is the language of economics, but can easily be misunderstood. MNCs must be aware that not all balance sheets fall under the same guidelines. Now that Croatia is a member of the EU, account managers should take the time to standardize balance sheets to cooperate better with international firms. If foreign direct investors have a clear picture of the accounts of a Croatian firm, they may be more likely to do business with them. Standardized accounts are important in international business, and it would benefit Croatia to improve their accountancy functions within their firms, allowing an easier transition functionally into the global marketplace.

These implications are not the sole issues surrounding Croatia's accession into the EU. However, they provide a basis of the issues that Croatia is facing as the newest member of the EU. As time goes on, there will be more implications. Problems will be fixed but new problems will arise. It is important for policy makers to make decisions based on both the citizens of Croatia and the economics of the country. The growth and welfare of both Croats and the economy would exemplify a successful accession into the EU, but as the comparisons show, there are many issues that need to be resolved for Croatia's accession to be so smooth. The

implications provide a view of how the lives of both citizens and firms can be affected by Croatia's accession into the EU.

## **Conclusion**

This study set out to determine the possible economic success or failure of Croatia in the European Union based on three economic indicators: FDI, unemployment, and infrastructure. It also sought to compare other economic indicators such as GDP growth and inflation of Croatia to the 27 other member-states of the European Union. The goal was to see where Croatia stands in relation to the other countries, which were organized into groups defined by GDP per capita. The main research question the paper attempted to answer was: Will FDI, unemployment, and infrastructure play a role in Croatia's success as a member of the EU? And how does Croatia compare to the other 27 member states based on other economic indicators; who will Croatia act most like as the newest member of the EU?

The main findings of the research are chapter specific within the respective chapters: foreign direct investment, unemployment, infrastructure, and country comparisons. In general, Croatia is lacking in FDI and extremely high in unemployment, while infrastructure is on par with that of other transition economies. The thesis defined and explained FDI opportunities, analyzed unemployment trends, and discussed infrastructure. The relationship between FDI, unemployment, and infrastructure in Croatia is just as important as each individual discussion, as each indicator affects the other. In simple terms, infrastructure projects attract FDI and FDI creates jobs. From this relationship, it is seen how the three factors must work together to produce an efficient economy capable of competing successfully in the

EU market. Many of the FDI projects determined by the U.S. Department of Commerce include infrastructure projects. When countries arrive and take advantage of the investment opportunities presented, jobs will be created. In conclusion, job creation and stabilization is the most important issue that Croatia faces to secure its economic growth. If Croatia does not attract more foreign investment and reduce their unemployment levels, the country will greatly suffer.

Croatia must implement stronger policies in the fields of labor and FDI. This could include improving the job search centers to better assist the unemployed and improve job turnover rates. Croatia does not yet have the free movement of citizens to other EU countries, so when that occurs, Croats can more easily move to other EU countries to possibly find jobs. In terms of FDI, the government should work hard to make industries more attractive. Croatia changed dramatically over the course of negotiations into the EU with regards to corruption, so the government should be willing and able to assist industries in becoming more attractive to foreign investors. It would be beneficial for the Croatian government to combine the sectors of infrastructure and FDI, which would in return decrease unemployment. By focusing on the opportunities provided by the Croatian infrastructure, it is possible for Croatia to achieve economic success, but not before increasing FDI and decreasing unemployment.

Limitations to my study include that FDI, unemployment, and infrastructure are not the only three factors that determine countries' further actions in the EU. It is impossible to determine the future of a country by only looking at three factors, but these indicators reveal that Croatia must make reforms and change quickly if they want to be a major economic player in the EU market. It is acknowledged that many

other factors, both economical and social, are included in the overall picture. A few different sectors were discussed in Chapter 7 on Managerial Implications, but not to a great extent as it would be impossible to include each economic factor in this research project. This leaves room for further research to be conducted, to see the effects and comparisons of other economic or social factors in relation to EU accession. Since accession into the EU is difficult to determine over a short period of time, this project allows for future research to follow Croatia's growth, or lack of, as they continue as the newest member-state, as there will be effects in the short, mid, and long run.

In conclusion, FDI, unemployment, and infrastructure prove to be factors in Croatia's future in the EU, while FDI and unemployment are the main impediments to growth before Croatia can make great strides in the EU market. If Croatia continues to expand infrastructure, the country will have a stronger gateway to the EU market. Croatia was found to be the most similar to Group 3 of countries in the EU, those with the lowest GDP per capita. However, they did not measure the lowest in any indicator, suggesting further improvement could push Croatia into Group 2 of middle-income countries relative to the EU. The road Croatia follows as the newest member of the EU in 2013 will determine the state of the EU market in relation to transition economies' ability to function in the market. The indicators suggest that Croatia will need to make adjustments before being a "successful" member of the EU.



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